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No. 92-212

In The

Supreme Court of the United States

October Term, 1992

BARCLAYS BANK PLC,

Petitioner,

v.

FRANCHISE TAX BOARD,
An Agency of the State of California,

Respondent.

On Petition For A Writ Of Certiorari
To The California Supreme Court

BRIEF OF RESPONDENT FRANCHISE TAX BOARD IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether there is a "final judgment" under the jurisdictional test set by 28 U.S.C. § 1257 when the California Supreme Court has decided a Foreign Commerce Clause issue but has remanded the state tax refund case to a lower California court for consideration of due process issues which, if all were determined in taxpayers' favor, would result in a complete judgment for taxpayers.

2. If this Court has jurisdiction to consider this case at this time, whether the California Supreme Court properly declined to apply a dormant Commerce Clause analysis and properly held that, due to congressional acquiescence, California did not violate the Foreign Commerce Clause by application of worldwide combined reporting to determine the taxable California income of the Barclays taxpayers.

3. If there is such jurisdiction, and if there has been no violation of the Foreign Commerce Clause, whether California's application of worldwide combined reporting to the Barclays taxpayers was nevertheless preempted by the United States Constitution as an intrusion into an inherently federal area; specifically, whether the Executive Branch's foreign affairs powers can eclipse Congress' exercise of its treaty and Commerce Clause powers to permit such state use of worldwide combined reporting.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES iv

JURISDICTION 1

STATUTORY AND CONSTITUTIONAL PROVISIONS 2

SUPPLEMENTAL STATEMENT OF THE CASE 2

1. The California Tax Filings of Petitioners and the Adjustments Made by the Franchise Tax Board 2

2. Awareness of the Use of the Worldwide Combined Report Method of Determining Income ... 4

3. The United States/United Kingdom Tax Treaty . 5

4. The California Water's-Edge Election 6

5. This Court's Recognition of the Merits of Formulary Apportionment 6

ARGUMENT

I THIS COURT HAS NO JURISDICTION TO CONSIDER THIS CASE AT THIS TIME, FOR THE CALIFORNIA SUPREME COURT'S DECISION, WHICH REMANDED THE CASE TO THE COURT OF APPEAL FOR CONSIDERATION OF TAXPAYERS' DUE PROCESS ISSUES, IS NOT A "FINAL JUDGMENT" AS REQUIRED BY 28 U.S.C. § 1257 8

TABLE OF CONTENTS – Continued

Page

II THE CALIFORNIA SUPREME COURT HAS PROPERLY APPLIED THIS COURT'S *WARDAIR* DECISION IN HOLDING THAT CONGRESSIONAL ACQUIESCENCE IN CALIFORNIA'S USE OF WORLDWIDE COMBINED REPORTING IS DETERMINATIVE OF THE COMMERCE CLAUSE ISSUE, WITH NO NEED FOR ANY DORMANT COMMERCE CLAUSE ANALYSIS..... 17

III THE DETERMINATION OF THE FOREIGN COMMERCE CLAUSE ISSUE IN THIS CASE ECLIPSES ANY FOREIGN AFFAIRS PREEMPTION ISSUE 26

CONCLUSION 29

TABLE OF AUTHORITIES

Page

CASES

Alcan Aluminum Corporation v. *Franchise Tax Board*, Cal. Ct. of Appeal Nos. 2 Civ. No. B065648, 3 Civ. No. 11530) 15

Allied-Signal, Inc. v. *Director, Div. of Taxation*, ___ U.S. ___ , 112 S.Ct. 2251 (1992) 8

Brady v. *Maryland*, 373 U.S. 83 (1963) 11

California v. *Rooney*, 483 U.S. 307 (1987) 9, 10

Cohan v. *Alvord*, 162 Cal.App.3d 176 (1984) 13

Construction Laborers v. *Curry*, 371 U.S. 542 (1963) 14

Container Corp. of America v. *Franchise Tax Bd.*, 463 U.S. 159 (1983) 7, 18, 19, 27, 28

Cox Broadcasting Corp. v. *Cohn*, 420 U.S. 469 (1975) 10, 11, 12, 13

Dames & Moore v. *Regan*, 453 U.S. 654 (1981) 26

Dows v. *Chicago*, 11 Wall. 108 (1871) 16

Fair Assessment in Real Estate Assn. v. *McNary*, 454 U.S. 100 (1981) 15, 16

Flynt v. *Ohio*, 451 U.S. 619 (1981) 9, 13, 14, 15

Fort Wayne Books, Inc. v. *Indiana*, 489 U.S. 46 (1989) 14

Franchise Tax Bd. of Cal. v. *Alcan Aluminium*, 493 U.S. 331 (1990) 16

Hathorn v. *Lovern*, 457 U.S. 255 (1982) 9, 10

Hines v. *Davidowitz*, 312 U.S. 52 (1941) 27

Illinois Com. Men's Assn. v. *State Bd. of Equalization*, 34 Cal.3d 839 (1981) 13

TABLE OF AUTHORITIES – Continued

Page

Kraft General Foods v. *Iowa Dept. of Revenue*, ___ U.S. ___, 112 S.Ct. 2365 (1992) 18

Lewis v. *Reynolds*, 284 U.S. 281 (1932) 8

Mercantile National Bank v. *Langdeau*, 371 U.S. 555 (1963) 14

Minnick v. *California Dept. of Corrections*, 452 U.S. 105 (1981) 12

Monroe v. *Pape*, 365 U.S. 167 (1961) 16

O'Dell v. *Espinoza*, 456 U.S. 430 (1982) 10

Radio Station WOW, Inc. v. *Johnson*, 326 U.S. 120 (1945) 9, 11

San Diego Gas & Electric Co. v. *San Diego*, 450 U.S. 621 (1981) 12

Southland Corp. v. *Keating*, 465 U.S. 1 (1984) 14

Trinova Corp. v. *Michigan Dept. of Treasury*, ___ U.S. ___, 111 S.Ct. 818 (1991) 7

Underwood Typerwriter Co. v. *Chamberlain*, 254 U.S. 113 (1920) 7

United States v. *Curtiss-Wright Export Corp.*, 299 U.S. 304 (1936) 22, 26

United States v. *Guy W. Capps, Inc.*, 204 F.2d 655 (4th Cir. 1953) 22, 27

Wardair Canada, Inc. v. *Florida Dept. of Revenue*, 477 U.S. 1 (1986) ..... *passim*

Western & Southern L.I. Co. v. *Bd. of Equalization*, 451 U.S. 648 (1981) 22

Zschernig v. *Miller*, 389 U.S. 429 (1968) 27, 28

TABLE OF AUTHORITIES – Continued

Page

CONSTITUTIONAL PROVISIONS

U.S. Const. art. I § 8(3) (Commerce Clause) ..... *passim*

U.S. Const. art. II § 2 ..... 2, 28

U.S. Const. art. VI (Supremacy Clause) 28

Due Process Clause 9, 10, 12, 13

Equal Protection Clause 14, 15

Cal. Const. art. I § 7 13

STATUTES

28 U.S.C. § 1257 ..... 1, 2, 8, 9, 17, 26

28 U.S.C. § 1341 16

42 U.S.C. § 1983 16

Federal Aviation Act 20

California Revenue and Taxation Code § 25110 . 2, 6, 15

OTHER AUTHORITIES

Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasions with Respect to Taxes on Income and Capital Gains (US/UK Treaty), Dec. 31, 1975, 31 U.S.T. 5668 ..... 5, 23, 24, 25, 28

Chicago Convention on International Civil Aviation 20, 21

124 Cong. Rec. (1978) 23, 24

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BRIEF OF RESPONDENT FRANCHISE TAX BOARD IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

JURISDICTION

Petitioner Barclays Bank PLC ("Barclays"), successor in interest to taxpayers Barclays Bank International, Inc. ("BBI") and Barclays Bank of California ("Barcal"), invokes jurisdiction under 28 U.S.C. § 1257(a). Respondent Franchise Tax Board argues below that there is not yet any final judgment from the California courts in this litigation.

STATUTORY AND CONSTITUTIONAL PROVISIONS

Petitioner Barclays has included some of the relevant constitutional and statutory provisions in Appendix D to the petition. Appendix A to this brief in response contains the following: a portion of article II, section 2 of the United States Constitution; a portion of 28 U.S.C. § 1257(a); and California Revenue and Taxation Code section 25110.

SUPPLEMENTAL STATEMENT OF THE CASE

Respondent Franchise Tax Board believes that petitioner Barclays' statement regarding the case (Petition for Certiorari ("Pet.") 3-14) contains significant omissions. Therefore, pursuant to Rule 15.1, the Franchise Tax Board provides this Court with this supplemental statement. This supplement, which is not necessary to the jurisdictional argument presented below at pp. 8-17, should be read in conjunction with and in addition to both Barclays' statement and the California Supreme Court's statement of the factual, procedural, legislative and case law background, which is included herein by reference. Most citations herein are to the appendices to the Petition for Writ of Certiorari.

1. The California Tax Filings of Petitioners and the Adjustments Made by the Franchise Tax Board.

The Barclays Group conducted its business in California through two corporate entities during the year in issue. Barclays Bank of California ("Barcal"), a wholly

owned, California incorporated, subsidiary of Barclays Bank International Limited ("BBI"), conducted a commercial banking business in the State of California. C-38, #9. BBI, a wholly owned, United Kingdom incorporated, subsidiary of Barclays Bank Limited ("BBL"), conducted business in California as a banking agency. C-36, #1. BBI was engaged in general retail and commercial banking, leasing, and consumer and commercial finance, directly or through subsidiaries, in approximately fifty-five (55) countries and territories during 1977. C-37, #2.

Both corporations filed California Franchise Tax returns for the year at issue. Barcal filed a return which included in its calculations only its individual income and activities. C-39-40, #19. BBI filed a return based upon a worldwide combined report which included all of its worldwide income and activities, and the worldwide income and activities of all of its controlled subsidiaries, including Barcal. C-39, #18. The income which served as a measure of BBI's California tax was determined by applying an apportionment formula, which compared BBI's California activities to the worldwide activities of BBI and its subsidiaries, to the worldwide net income of BBI and its subsidiaries.

At audit the Franchise Tax Board determined that Barcal, BBI and all of BBI's other subsidiaries were part of a single unitary business which also included BBL, the parent company of BBI, and all of the other controlled subsidiaries of BBL. C-38, #14. As a result of this determination the Franchise Tax Board recomputed the California tax liabilities of Barcal and BBI upon the basis of a combined report which included all of the income and activities of the entities determined to be in the unitary

business, from which the California net incomes of Barcal and BBI were reached by formulary apportionment. C-38, #15; C-39, #16; A-5. For purposes of this litigation it is agreed that BBL and all of its majority-owned subsidiaries, including BBI and Barcal, are a single unitary business. A-2, C-37 #8, C-42 #27.

BBI and Barcal pursued administrative remedies with the Franchise Tax Board, and modifications were made to the original audit calculations of the amount of income attributed to California. BBI and Barcal paid the modified assessments and filed a suit for refund asking for the return of all tax and interest amounts paid which were over the amounts paid with their original returns. Neither BBI (C-41, #25) nor Barcal (C-41, #24) have claimed that the amount of tax paid with their original returns was erroneous.

2. Awareness of the Use of the Worldwide Combined Report Method of Determining Income.

There is evidence which suggests international awareness of the use of formula apportionment and the unitary method at least from the mid-1950's on. A-33. As early as the late 1940's the United States negotiators of Friendship Commerce and Navigation agreements recognized the existence of formulary approaches. A-34. The use of formula apportionment as an alternative to the arm's-length/separate accounting method penetrated the international financial and diplomatic consciousness as early as 1924. A-32.

The debate on the States' use of worldwide combined reporting ("WWCR") methodologies was recognized by

the Executive Branch of the federal government as spanning at least two decades as of 1984. A-33, n. 14. Congressional bills dealing in part with the subject of the states' use of WWCR have been introduced since at least 1965 (A-31) and have included measures sponsored by the United States Treasury. For over 25 years senior tax and foreign policy officials of the Executive Branch had been aware of the complaints and demands of foreign governments regarding worldwide combined reporting. A-27.

3. The United States/United Kingdom Tax Treaty.

In 1975, the Ford administration concluded negotiation of a bilateral income tax convention ("US/UK Treaty") with the United Kingdom which would have prevented the use of the WWCR methodology here at issue. A-28. In 1978, with explicit recognition of the "negative implications" of its act, the United States Senate *rejected* the income tax convention negotiated by the executive branch. A-27. It was only approved after the clause limiting the states' use of worldwide combined reporting was removed. A-27. In the wake of the Senate rejection of the limiting clause, the executive scuttled its effort to achieve a treaty-imposed curb on the states' use of WWCR. A-28 and A-37, n. 20.

The Parliament of the United Kingdom ratified the treaty in 1980, without the clause prohibiting the states' use of WWCR. A-30, n. 11 and C-56, #40gg. The ratification occurred after representative of the two countries negotiated the Third Protocol to the Treaty. C-56, #40gg.

In 1985 Parliament enacted legislation which empowered the Prime Minister to institute retaliatory taxation against United States companies if the use of WWCR was continued. C-49, #34. This power has never been exercised. The Executive Branch has indicated to Congress that exercising this power would constitute a clear violation of the treaty by the United Kingdom. Exh. 37i, p. 12.

4. The California Water's-Edge Election.

In 1986 California enacted legislation which allows both foreign and domestic based businesses to elect out of the use of WWCR in favor of a "water's-edge" method, which in general confines WWCR to United States incorporated entities, certain tax advantage subsidiaries of United States corporations and, in limited circumstances, some portion of foreign incorporated entities. A-36 and C-73, #55; Cal. Revenue and Taxation Code § 25110 (see Appendix A hereto). The enactment of the California water's-edge legislation prompted senior Treasury officials to retreat from their previous insistence that Congress prohibit state use of worldwide formula apportionment. A-36-37.

5. This Court's Recognition of the Merits of Formulary Apportionment.

As noted above, worldwide combined reporting is based upon formulary apportionment of the total net income of a unitary business. Use of such formula apportionment of income does not result in a taxation of non-

California corporations or in a taxation of non-California income; it is only the means of determining what portion of the unitary income can be fairly attributed to the part of the unitary business that is actually being carried out in California. *Container Corporation* v. *Franchise Tax Board*, 463 U.S. 159, 164-65, 184, 192 (1983) (hereinafter "*Container*").

The *Container* decision, *id.*, upheld the merits of California's use of unitary apportionment and WWCR as to worldwide unitary businesses headed by domestic corporations. The *Container* Court held California's version of WWCR to be a "proper and fair method of taxation" (463 U.S. at 184) which reflects "a reasonable sense of how income is generated" (*id.* at 169-70) and which avoids the "basic theoretical weaknesses" of arm's length/separate accounting methods (*id.* at 181), the alternative to WWCR which petitioner Barclays claims must be applied to the Barclays taxpayers. Among the separate accounting weaknesses pointed out in *Container* are that separate accounting "is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise" (*id.* at 164-65).

As this Court stated in *Trinova Corp.* v. *Michigan Dept. of Treasury* , ___ U.S. ___, 111 S.Ct. 818, 831 (1991), "since *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920), we have recognized the impracticability of assuming that all income can be assigned [by geographic designation] to a single source." This Court has very recently stated, "The principal virtue of the unitary business principle of taxation is that it does a better job of accounting

for 'the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise' than, for example, geographical or transactional accounting." *Allied-Signal, Inc.* v. *Director, Div. of Taxation*, ___ U.S. ___, 112 S.Ct. 2251, 2261 (1992).

ARGUMENT

I

THIS COURT HAS NO JURISDICTION TO CONSIDER THIS CASE AT THIS TIME, FOR THE CALIFORNIA SUPREME COURT'S DECISION, WHICH REMANDED THE CASE TO THE COURT OF APPEAL FOR CONSIDERATION OF TAXPAYERS' DUE PROCESS ISSUES, IS NOT A "FINAL JUDGMENT" AS REQUIRED BY 28 U.S.C. § 1257.

The ultimate issue to be finally determined in a taxpayer's tax refund suit is whether the taxpayer has overpaid its tax. *Lewis* v. *Reynolds*, 284 U.S. 281, 283 (1932). That issue clearly has not yet been determined by the California courts. The California Supreme Court has decided the Foreign Commerce Clause issue in favor of the Franchise Tax Board, and it has remanded the case back to the California Court of Appeal for consideration of due process issues. If all those due process issues were to be determined in taxpayers' favor, taxpayers would then receive a final and favorable California judgment for refunds of their taxes as prayed for in their complaints. Such a judgment in favor of taxpayers would render moot the Foreign Commerce Clause issue and holding as to this case, unless the Franchise Tax Board petitioned this Court

for relief from the Due Process Clause judgment and taxpayers preserved the Foreign Commerce Clause issue in their response. On the other hand, if taxpayers ultimately lose the Due Process Clause issue in a final judgment rendered by the highest California court in which a decision could be had, there can be no question that taxpayers then properly could raise both the Due Process Clause issues and the Foreign Commerce Clause issues in a petition for certiorari to this Court. *Hathorn* v. *Lovern*, 457 U.S. 255, 261 (1982); accord, *California* v. *Rooney*, 483 U.S. 307, 311-12 n. 2 (1987).

Under these circumstances, is the California Supreme Court's May 1992 interlocutory opinion a "final judgment" for purposes of section 1257 jurisdiction? Proper application of this Court's recent decisions establishes that it is not.

28 U.S.C. § 1257 limits the jurisdiction of this Court in state-originated cases to "[f]inal judgments or decrees rendered by the highest court of a State in which a decision could be had. . . . " "In general, the final-judgment rule has been interpreted 'to preclude reviewability . . . where anything further remains to be determined by a state court, no matter how dissociated from the only federal issue that has finally been adjudicated by the highest court of the State.' *Radio Station WOW, Inc.* v. *Johnson*, 326 U.S. 120, 124 (1945)." *Flynt* v. *Ohio*, 451 U.S. 619, 620 (1981). One of the goals behind the final-judgment rule is to avoid piecemeal review of the various federal issues which might be present in a particular case. See *id.* at 621. If this Court were to take this case now and sustain the California Supreme Court on the merits of the Foreign Commerce Clause issue, this

Court could well then be faced, either later this term or next term, with a petition from a final California decision on Due Process Clause issues in the same litigation.

Barclays, citing *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. 469 (1975), argues that the California Supreme Court's decision "meets the criteria established by this Court for finality under 28 U.S.C. § 1257 where further state proceedings may occur. *Cox*, 420 U.S. at 476-87." Pet. 27. But Barclays never singles out nor completely sets forth any of the four *Cox* exceptions to the general rule. The reason for this omission is clear: Barclays' circumstances meet none of the four exceptions in *Cox*.

The *Cox* decision provides "a limited set of situations" which provide exceptions to the above general rule. *O'Dell* v. *Espinoza*, 456 U.S. 430 (1982). There are four categories of cases listed in *Cox* as comprising that limited set of exceptions. The first and third categories are not pertinent here.[1] The second and fourth categories deserve attention.

The wisdom of applying the final-judgment rule to deny jurisdiction in this case can be demonstrated by a

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[1] The first exception does not apply here because the Foreign Commerce Clause determination is not conclusive of the rest of the state proceedings – the case is not for all practical purposes concluded. See *Cox*, 420 U.S. at 479. The third exception is not applicable here because Barclays would be able to seek review in this Court on the Foreign Commerce Clause issue if Barclays were to lose on the merits in the further California proceedings. See *Cox*, 420 U.S. at 481; see also *Hathorn* and *Rooney*, cited above at p. 9.

close analysis of the second *Cox* exception. *Cox* presents the second exception as follows:

> "Second, there are cases such as *Radio Station WOW, supra,* and *Brady v. Maryland,* 373 U.S. 83 (1963), in which the federal issue, finally decided by the highest court in the State, will survive and require decision regardless of the outcome of future state-court proceedings. In *Radio Station WOW,* . . . [t]he federal issue was held reviewable here despite the pending [state proceedings] on the 'presupposition . . . that the federal questions that could come here have been adjudicated by the State court, and that the [further state proceedings] could not remotely give rise to a federal question . . . that may later come here. . . . ' 326 U.S., at 127. . . . Nothing that could happen in the course of the [further state proceedings], short of settlement of the case, would foreclose or make unnecessary decision on the federal question." 420 U.S. at 480.

The second exception in *Cox* is premised upon two conditions: (1) that no further decision of the state courts will render moot the federal question which has already been decided, and (2) that no other federal question will be a subject of the state court proceedings to come. Barclays argues in part that this Court should take jurisdiction immediately in order to keep the Foreign Commerce Clause question from becoming moot. To the contrary, the second exception in *Cox* establishes that if the federal question might be rendered moot in the further state proceedings, that usually is sufficient reason to find that there has *not* been a "final judgment" in the state courts. This approach is tied to this Court's recognition that the final-judgment limitations on this Court's jurisdiction are

closely connected to the " 'policy of strict necessity in disposing of constitutional issues. . . . ' " *Minnick* v. *California Dept. of Corrections*, 452 U.S. 105, 122-23 & n. 30 (1981).

By also conditioning this second exception in Cox upon the absence of any possibility that any other federal question might arise in the remaining state court proceedings, this exception avoids the possibility of there being two or more "final judgments" in the same state case, a situation which could give rise to piecemeal consideration by this Court of various federal issues in the same state case. The present case provides an example: immediate consideration on the merits of Barclays' Foreign Commerce Clause claims could well be followed soon by another petition on Due Process Clause grounds, with both petitions arising from exactly the same California litigation. To avoid this situation, this Court has held that when further state proceedings are *necessary* to resolve another federal question, there is no "final judgment" and thus no jurisdiction under section 1257. *San Diego Gas & Electric Co.* v. *San Diego*, 450 U.S. 621, 633 (1981).

Although the second *Cox* exception clearly does not apply to this case, its consideration in the context of this case demonstrates some of the reasons why the present case should not be excepted from the general rule. Any attempt to expand any other exception from *Cox* in order to apply it here should be given extremely careful scrutiny.

Without being specific, Barclays refers to just a portion of the fourth exception in *Cox*. In order for this Court to have jurisdiction, Barclays must establish that this case

now meets *all* of the necessarily intertwined conditions of the fourth exception. See *Flynt* v. *Ohio*, 451 U.S. 619. That exception requires that (1) "the federal issue has been finally decided in the state courts with further proceedings pending in which *the party seeking review here might prevail on the merits on nonfederal grounds*, thus rendering unnecessary review of the federal issue by this Court," (2) "reversal of the state court on the federal issue would be preclusive of any further litigation on the relevant cause of action rather than merely controlling the nature and character of, or determining the admissibility of evidence in, the state proceedings still to come," and (3) "a refusal immediately to review the state-court decision might seriously erode federal policy. . . . " *Cox*, 420 U.S. at 482-83 (emphasis added).

The first requirement for this exception is not met by this case. While the Franchise Tax Board has argued that there are California procedural bars to the consideration of the due process claims on their merits, there is no way that Barclays can ultimately prevail on the merits in the further state proceedings without establishing that there has been a denial of due process of law.[2]

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[2] Although article I, section 7 of the California Constitution also guarantees "due process" rights, that provision has not been interpreted in tax cases as providing any rights different from those guaranteed in the federal Due Process Clause. See *Cohan* v. *Alvord*, 162 Cal.App.3d 176, 184-86 (1984); *Illinois Com. Men's Assn.* v. *State Bd. of Equalization*, 34 Cal.3d 839 (1981). In this case the Barclays taxpayers have never argued to the California courts that the California due process guarantee has a broader coverage here than the federal Due Process Clause.

The third requirement for this *Cox* exception also is not met in this case. The third requirement has been satisfied in cases where First Amendment rights are directly at stake in the delays involved in further state proceedings (see, *e.g.*, *Fort Wayne Books, Inc.* v. *Indiana*, 489 U.S. 46, 55-56 (1989)) and cases where the federal question involves such procedural questions as proper jurisdiction, venue, or arbitration with regard to which the claimed federal interest would be sacrificed or seriously undermined by continuation of contrary state court procedures (see, *e.g.*, *Southland Corp.* v. *Keating*, 465 U.S. 1, 6-9 (1984); see also *Mercantile National Bank* v. *Langdeau*, 371 U.S. 555 (1963), and *Construction Laborers* v. *Curry*, 371 U.S. 542 (1963), which are cited as examples for the fourth exception in *Cox*, 420 U.S. at 483, and in *Flynt* v. *Ohio*, 451 U.S. 619, 622 (1981)).

In *Flynt*, *id.*, this Court refused to consider whether permitting a particular criminal prosecution to proceed in state courts was violative of the Equal Protection Clause, holding that the resolution of that question could await final state judgment without "any adverse effect upon important federal interests." *Id.* at 122. This Court reached this holding even though the first two conditions of the fourth *Cox* exception were met. In the words of this Court, "A contrary conclusion would permit the fourth exception to swallow the rule." *Id.* at 622. In other words, the mere fact that the state courts had reached their final holding on a vital federal constitutional issue does not mean that a delay in United States Supreme Court review of that holding will "seriously erode federal policy."

Barclays argues that failure to give immediate review to the California Supreme Court's interlocutory decision

would seriously erode an alleged "federal economic policy of promoting a uniform standard for division of income for tax purposes between nations."[3] Barclays fails to explain why Barclays' purported economic policies somehow must be protected immediately in this case while the Equal Protection Clause claims in the criminal proceedings in *Flynt* could wait.[4]

Barclays fails to recognize that there is an extremely strong federal policy of comity which would be seriously eroded if Court *were* to take this case at this juncture. This Court has long recognized that " 'the modes adopted [by the states] to enforce the taxes levied should be interfered with as little as possible.' " *Fair Assessment in Real Estate*

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[3] Barclays fails to recognize that if, as the California Supreme Court has held, Congress has taken this case out of the dormant Commerce Clause context by acquiescence in California's taxing procedures, there can be no federal economic policy which can overshadow this congressional position.

[4] In making this argument, Barclays also fails to inform this Court that under current California law, Barclays subsidiaries doing business in California can choose to not have worldwide combined reporting used in the determination of their taxes; thus such Barclays subsidiaries do not need to experience worldwide combined reporting while the California state court proceedings proceed to a truly final judgment. See Pet. App. A-36 & n. 19, citing Cal. Rev. & Tax Code § 25110 et seq. Barclays also fails to inform this Court of two other cases (*Alcan Aluminum Corporation* v. *Franchise Tax Board*, Cal. Ct. of Appeal Nos. 2 Civ. No. B065648, 3 Civ. No. 11530), currently proceeding in two separate districts of the California appellate courts, wherein another taxpayer is actively raising the same Foreign Commerce Clause issue which Barclays wishes to argue now in this Court. Thus even if the Foreign Commerce Clause issue is mooted out in Barclays' further state court proceedings, another taxpayer may soon be asking this Court to consider it.

Assn. v. *McNary*, 454 U.S. 100, 102 (1981), quoting *Dows* v. *Chicago* 11 Wall. 108, 110 (1871).[5] In *Fair Assessment* this Court held that, as long as the state legal tax remedies were "plain, adequate, and complete," the above fundamental principle of comity in determining constitutional issues in state tax cases overcame the doctrine, enunciated in *Monroe* v. *Pape*, 365 U.S. 167 (1961), that comity does not apply in civil rights damages cases brought under 42 U.S.C. § 1983. 454 U.S. at 116.[6] This fundamental federal principle of comity with regard to state taxes certainly outweighs and overwhelms Barclays' purportedly applicable economic policy. Given this fundamental federal principle of comity in cases dealing with state taxes, a principle which strongly favors allowing state tax proceedings to go to true completion before reviewing any federal issues in this Court, it is even more clear that *Cox*'s fourth exception to the "final judgment" rule does not apply in this case.

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[5] In 28 U.S.C. § 1341, which bars the federal district courts from jurisdiction to enjoin the assessment or collection of state taxes where there is a plain, speedy and efficient remedy in the state courts, "Congress also recognized that the autonomy and fiscal stability of the States survive best when state tax systems are not subject to scrutiny in federal courts." *Fair Assessment in Real Estate Assn.*, 454 U.S. at 102-03. "This legislation, and the decisions of this Court which preceded it, reflect the fundamental principle of comity between federal courts and state governments that is essential to 'Our Federalism,' particularly in the area of state taxation." *Id.* at 103.

[6] This Court has specifically held under 28 U.S.C. § 1341 that the California tax refund remedies now being pursued in the California courts are plain, speedy and efficient. *Franchise Tax Bd. of Cal.* v. *Alcan Aluminium*, 493 U.S. 331, 338-41 (1990).

There has been no final judgment in the California courts as jurisdictionally required by 28 U.S.C. § 1257. Barclays' current petition for certiorari should be denied.

II

THE CALIFORNIA SUPREME COURT HAS PROPERLY APPLIED THIS COURT'S *WARDAIR* DECISION IN HOLDING THAT CONGRESSIONAL ACQUIESCENCE IN CALIFORNIA'S USE OF WORLDWIDE COMBINED REPORTING IS DETERMINATIVE OF THE COMMERCE CLAUSE ISSUE, WITH NO NEED FOR ANY DORMANT COMMERCE CLAUSE ANALYSIS.

Respondent Franchise Tax Board submits that, even if this Court did have jurisdiction to grant Barclays' petition, the California Supreme Court has correctly applied existing precedent of this Court. Under these circumstances there would be no need for this Court to exercise its jurisdiction.

The California Supreme Court's Commerce Clause holding is based upon an application of *Wardair Canada, Inc.* v. *Florida Dept. of Revenue*, 477 U.S. 1 (1986) (hereinafter "*Wardair*"), to conclude that Congress has acted to acquiesce in the state tax practice which Barclays is challenging. That being so, the California Supreme Court pointedly did not engage in any dormant Commerce Clause analysis. A-39.[7] Barclays spends most of its

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[7] Given the California Supreme Court's holding, respondent Franchise Tax Board will not in this response engage in a lengthy dormant Commerce Clause analysis. No admission should be inferred from this attempt at succinctness; the Franchise Tax Board stands ready to establish its dormant Commerce Clause position if called upon to do so by a granting by this Court of Barclays' petition.

petition attempting to make points which only are relevant to a dormant Commerce Clause analysis. Other than a few citations, Barclays confines its *Wardair* contentions to two partial pages near the back of its petition. Pet. 22-23.

In *Wardair* this Court cautioned that "It would turn dormant Commerce Clause analysis entirely upside down to apply it when the Federal Government has acted, and to apply it in such a way as to reverse the policy that the Federal Government has elected to follow." *Id.* at 12. In criticizing the California Supreme Court for "disregard[ing]" established dormant Commerce Clause criteria (Pet. 17) in a case where Congress has acted to allow the state tax practice in issue, the Barclays petition attempts to lead this Court into just such an upended and illogical exercise.[8]

In *Container Corp. of America* v. *Franchise Tax Board*, 463 U.S. 159 (1983) (hereinafter "*Container*"), this Court held that California's worldwide combined reporting method as applied to a multinational unitary business with a domestic ultimate parent was constitutional. This Court reserved the question of whether it would reach

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[8] There is no need or basis to apply in this case the results or dormant Commerce Clause analysis from such cases as *Kraft General Foods* v. *Iowa Dept. of Revenue*, ___ U.S. ___, 112 S.Ct. 2365 (1992), cited Pet. at 16, 19, 24, and 26. The fact that the dormant Commerce Clause analysis is broader in the foreign commerce context than in the domestic context (*id.* at 2370) cannot affect Congress' total power to remove *all* Commerce Clause restrictions upon any state tax practice in which Congress chooses to acquiesce. See also n. 11 below at p. 22.

the same result if (as in this case) the ultimate parent corporation were foreign. 463 U.S. at 193-97.[9]

Three years after *Container*, in *Wardair*, this Court provided the analytic tool which, as properly applied by the California Supreme Court to uncontradicted facts in the current record, mandates the resolution of this reserved question in favor of California's use of WWCR. Noting that a *dormant* Commerce Clause analysis should not be applied when federal law indicates an authoritative federal decision to *permit* the challenged state tax, this Court held in *Wardair* that such a permissive decision can exist by *implication*, i.e., under circumstances where

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[9] When dealing with the question of the "one voice" of the federal government in foreign commerce, the *Container* Court only considered whether California's application of WWCR *violated* either one of two branches of the one voice standard, indicating that the state tax "will violate the 'one voice' standard if it *either* implicates foreign policy issues which must be left to the Federal Government [the dormant clause branch of the standard] *or* violates a clear federal directive." 463 U.S. at 194 (emphasis by the Court). Thus the only non-dormant Foreign Commerce Clause analysis in *Container* was a consideration whether the one voice had spoken to *preempt* California's use of WWCR. *Id.* In the words of the *Barclays* trial court, *Container* "did not address the question of whether such policy was expressed Congressionally *for* it." C-31 (emphasis by the court). The *Container* Court's consideration of "specific indications of congressional intent" (463 U.S. at 196) was restricted to the preemptive analysis, with the Court deciding that "we cannot conclude that the California tax at issue here is preempted by federal law. . . . " *Id.* at 197. Since the *Container* Court did not even consider whether the federal government's one voice had spoken to *permit* California's use of WWCR, it certainly is not inconsistent with *Container* to apply the later *Wardair* analysis in the present case to find such permission.

there is no explicit statement of such permission. Such "implications" are to be drawn from "the *law* as it presently stands," not from any *"aspiration"* for what the law might become. *Id.* at 10 (emphasis by the Court).

In *Wardair*, a Canadian airline challenged Florida's imposition of a tax on all aviation fuel sold within the state insofar as that tax was assessed on fuel used by foreign airlines exclusively in foreign commerce. On the Commerce Clause issue in *Wardair*,[10] the taxpayer and the Solicitor General as amicus curiae argued that the Florida tax unconstitutionally interfered with the ability of the federal government to speak with one voice because there was a federal policy of exempting such fuel from tax. As evidence of the alleged federal "policy," Wardair and the Solicitor General principally relied on (1) the Chicago Convention on International Civil Aviation, an international treaty to which the United States and 156 other countries, including Canada, are parties; (2) a resolution adopted by the International Civil Aviation Organization in 1966; and (3) more than 70 bilateral agreements into which the United States has entered with various countries dealing with international aviation. Discussing each of these in turn, this Court pointed out: (1) that the Chicago Convention by its terms precludes the imposition of local taxes on fuel only when the fuel already is on

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[10] The *Wardair* Court also held that the Florida tax was not preempted by the Federal Aviation Act, but the Court explicitly stated that it did not rely on a permissive provision of that act "to answer the Commerce Clause issue" present in *Wardair*. 477 U.S. at 6-7. Thus Barclays errs in implying (Pet. 23) that the Federal Aviation Act served in any way as a basis for the *Wardair* Commerce Clause holding.

board an arriving aircraft, thus giving rise to the "negative implication" of "a decision by the parties to that convention to address the problem of [state and local taxation] by curtailing and limiting only some of the localities' power to tax, while implicitly preserving other aspects of that authority" (*id.* at 10); (2) that the resolution adopted by the ICAO, while it endorses an international scheme of tax exemption, is merely the work product of an international organization of which the United States is a member and has no force of law (*id.* at 11); and (3) that while most of the 70 bilateral agreements commit the United States to refrain from imposing national taxes of the type imposed by Florida, in none of these agreements has the United States agreed to deny the states the power to tax the sale of aviation fuel; in particular, the agreement between the United States and Canada makes *no mention* of taxation by political subdivisions, "an omission which must be understood as representing a policy choice by the contracting parties. . . . " *Id.* at 11.

This Court went on to say:

> "What all of this makes abundantly clear is that the Federal Government has not remained silent with regard to the question of whether States should have the power to impose taxes on aviation fuel used by foreign carriers in international travel. By *negative implication* arising out of more than 70 agreements entered into since the Chicago Convention, the United States has at least acquiesced in state taxation of fuel used by foreign carriers in international travel. Again, in the U.S.-Canadian Agreement only 'national' charges are barred, and we presume

> that drafters from two federalist nations understood this as representing a choice not to preclude local taxation. It would turn dormant Commerce Clause analysis entirely upside down to apply it when the Federal Government has acted, and to apply it in such a way as to *reverse* the policy that the Federal Government has elected to follow." *Id.* at 12 (emphasis in original).

Thus in *Wardair* the federal government had considered whether to bar a type of tax practice by international agreement, but the *states* were not restricted from applying that tax practice when the agreements were finally adopted as a part of United States law. Under this Court's *Wardair* rule, the implications to be drawn from such an action establish that in formulating federal law Congress has elected to permit the states to apply such a tax practice. *Id.* at 10, 12.[11]

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[11] It must be kept in mind that the United States Constitution gives the power to regulate foreign and interstate commerce to *Congress*. U.S. Const. art. I, § 8(3); Pet. App. D. Thus, as to foreign or interstate commerce matters, congressional action prevails over any conflicting actions or desires of the Executive Branch. See *United States* v. *Curtiss-Wright Export Corp.*, 299 U.S. 304 (1936); *United States* v. *Guy W. Capps, Inc.*, 204 F.2d 655 (4th Cir. 1953), aff'd on other grounds, 348 U.S. 296 (1955). If Congress has exercised its commerce powers so as to permit state action there cannot possibly be any violation of the Commerce Clause; once such permission is ascertained, "any action taken by a State within the scope of the congressional authorization is rendered invulnerable to Commerce Clause challenge." *Western & Southern L.I. Co.* v. *Bd. of Equalization* , 451 U.S. 648, 653 (1981); see also *Wardair*, 477 U.S. at 12-13. In short, in granting such permission Congress is unrestricted by any of the policy standards which would apply in a *dormant* Commerce Clause context.

In holding that the *Wardair* rule was applicable in the present case, the California Supreme Court placed its primary reliance on the United States/United Kingdom ("US/UK") Treaty which was negotiated and ratified in the 1970's. Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasions with Respect to Taxes on Income and Capital Gains, Dec. 31, 1975, U.S.-U.K., 31 U.S.T. 5668 (Exh. 40gg). For the first and only time, the federal Executive Branch negotiated a provision for that treaty, article 9(4), which would have explicitly prohibited any state's use of WWCR. A-29. After much debate, and several votes in the Senate, the treaty was only ratified when that provision was rendered totally inapplicable to the states by a reservation. 124 Cong. Rec. 18416 (June 22, 1978) (Exh. 36c), 19076 (June 27, 1978) (Exh. 36d); A-29. After more bargaining with the United Kingdom, wherein the United Kingdom exacted other federal tax concessions from the United States, the United Kingdom accepted the treaty with the prohibition of WWCR only applicable to the national governments, not to the states. 31 U.S.T. 5709, 5713 (Exh. 40gg). Thus the states' use of WWCR was directly considered as a tax issue in the formulation of the treaty, but the *states'* use of WWCR ultimately was not restricted in the final adoption of the treaty as a part of United States law.

The US/UK Treaty provides a perfect context for the application of the *Wardair* rule: a clear congressional consideration of whether a state tax practice (WWCR) should be permitted, and a final ratification of a treaty which by clear implication permitted the states' application of that tax practice (WWCR). At the time of the final Senate vote, the clear choice before the Senate was either to ratify the

US/UK treaty while permitting the states to use WWCR or (since ratification with original article 9(4) had proved impossible) not to ratify the treaty. See 124 Cong. Rec. 18709-12 (June 23, 1978) (statements of Senators Byrd, Church, Javits, Stevens, Sparkman, Cranston and Packwood) (Exh. 36d). By more than the required two-thirds vote (82 yeas, 5 nays), the Senate chose to ratify the treaty while permitting (by implication) state use of WWCR. 124 Cong. Rec. 19076 (June 27, 1978) (Exh. 36d). In the words of the *Wardair* decision, the Senate has "at least acquiesced" in the use of WWCR by the states, and under the *Wardair* holding such acquiescence is fully sufficient to establish that the federal government has "affirmatively decided to permit" state use of WWCR. 477 U.S. at 12-13.[12]

The California Supreme Court correctly analogized the present case to *Wardair*:

> "The parallels between this evidence of 'governmental silence' or refusal to act and that regarded as decisive in *Wardair, supra*, 477 U.S. 1, seem to us both evident and compelling. As in *Wardair*, an international agreement (here the bilateral income tax treaty between the United States and the United Kingdom) demonstrates that while federal executive branch officials *aspired* to eliminate a state tax practice (here the use of formula apportionment to calculate the tax liability of foreign-based multinationals),

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[12] Contrary to Barclays' attempt to characterize the Senate's ratification of the treaty as a "stalemate" (Pet. 23 n. 23), the final outcome was a clear defeat for those who had attempted to bar exactly the type of state tax practice which Barclays is challenging in this case.

> 'the *law* as it presently stands acquiesces' in the states' continued use of that practice. As in *Wardair*, the 'negative implications' of international agreements (here the tax treaty as ratified by the Senate) support recognition of a federal policy that *acquiesces* in the states' tax practice. And certainly, in the circumstances of Senate consideration detailed above, the explicit removal of 'political subdivisions' from the scope of article 9(4) effected by the Church reservation, like the omission of restrictions on taxation by political subdivisions in the international agreements considered in *Wardair*, 'must be understood as representing a policy choice by the contracting parties.' (*Wardair, supra*, 477 U.S. at p. 11.)" A-29-30 (emphasis in original; footnote omitted).

Recognizing that formula apportionment such as WWCR has been a matter of international interest from at least the mid-1950's (A-33-34), and noting that indications of such federal acquiescence also were to be found in the history of other bilateral income tax treaties (A-31-34) and in legislative histories of congressional bills (A-31), the California Supreme Court applied *Wardair* to hold that (1) California's application of WWCR in this case has been permitted by Congress under its Commerce Clause powers and (2) since Congress has acted to permit such application, no dormant Commerce Clause analysis was necessary. Respondent Franchise Tax Board submits that one does not have to do more than apply the *Wardair* rule to the US/UK treaty to determine that the California Supreme Court's holdings were fully consistent with all current precedents of this Court. The California Supreme Court has not formulated and applied a "new test" of its

own (see Pet. 12, 23, 24) to reach these holdings; it has correctly applied the test provided to it by this Court in *Wardair*. Even if these correct holdings of the California Supreme Court were held to constitute a "final judgment" under section 1257, there would be no need for this Court to take jurisdiction of this case.

III

THE DETERMINATION OF THE FOREIGN COMMERCE CLAUSE ISSUE IN THIS CASE ECLIPSES ANY FOREIGN AFFAIRS PREEMPTION ISSUE.

Even if section 1257 gave jurisdiction to consider a foreign affairs pre-emption issue on the merits, such an issue could not be determinative in this foreign commerce context. It is clear that at the heart of the California Supreme Court's opinion is an issue pertaining directly to the Foreign Commerce Clause. It is undisputed that the Constitution gives to Congress alone the power "[t]o regulate commerce with foreign nations. . . . " U.S. Const. art. I, § 8(3). If, as the Board contends, proper application of the *Wardair* rule in this case confirms that federal law pertaining to foreign commerce contains a permission for the states' use of WWCR, then no contrary foreign affairs aspirations of the Executive Branch could eclipse that permission. The Executive Branch's power in the field of foreign relations, " 'like every other governmental power, must be exercised in subordination to the applicable provisions of the Constitution.' " *Dames & Moore* v. *Regan*, 453 U.S. 654, 661 (1981), quoting *United States* v. *Curtiss-Wright Export Corp.*, 299 U.S. 304, 319-20 (1936).

But what of authorities such as *Hines* v. *Davidowitz*, 312 U.S. 52 (1941), and *Zschernig* v. *Miller*, 389 U.S. 429 (1968)? Barclays relies on these cases as barring any state act which has a direct impact upon foreign relations and which may well adversely affect the power of the central government to deal with foreign affairs issues. The answer in this case must be given in the foreign commerce context. If Congress has acted so as to permit state action in a foreign commerce context, no further authorization is needed, even though foreign relations necessarily are also involved. See *Wardair*, 477 U.S. at 12-13; see also *United States* v. *Guy W. Capps, Inc.*, 204 F.2d 655 (4th Cir. 1953), *aff'd on other grds.*, 348 U.S. 296 (1955). Alternatively, if there is a dormant Foreign Commerce Clause situation with no clear congressional directive, the *Container* decision teaches that a state tax at variance with the federal tax approach and affecting foreign commerce will violate the Foreign Commerce Clause if it " 'may impair federal uniformity in an area where federal uniformity is essential' . . . and 'prevents the Federal Government from "speaking with one voice" in international trade. . . . ' " 463 U.S. at 194. In reaching its Foreign Commerce Clause holding, the *Container* decision contains many references to "foreign affairs," "foreign relations," and "foreign policy" (see 463 U.S. at 189, 194, 195, 196, 197); it rejected the dissent's position that California's application of WWCR was "an intrusion on national policy in foreign affairs that is not permitted by the Constitution." 463 U.S. at 206 (dissent). Thus *Container* establishes that a holding that WWCR does not violate the dormant Foreign Commerce Clause includes consideration of foreign affairs issues, leaving no room for any determination that the federal

government's foreign affairs powers bar the application of WWCR to that taxpayer. If a state tax affecting foreign commerce is valid either by way of congressional authorization or under the dormant Foreign Commerce Clause tests (which include the balancing of foreign policy considerations), it cannot be made unconstitutional on the basis of infringement upon foreign affairs, particularly since the Congress and the President share authority over foreign affairs. *Container*, 463 U.S. at 196; *Zschernig* v. *Miller*, 389 U.S. 429, 432 (1968).

Application of Barclays' foreign affairs preemption argument in this case would also rewrite the treaty powers provisions of the United States Constitution. Congress, through the Senate's actions on the many bilateral income tax treaties, and through the Senate's action on article 9(4) of the US/UK Treaty, has taken affirmative action which allows the states to tax unfettered by separate accounting restrictions placed on the national government and unfettered by proposed article 9(4), and has therefore impliedly authorized state use of WWCR. This Court cannot construe the Executive Branch's foreign policy aspirations as authoritative federal policy without disabling not only Congress, but also the Constitution, which requires that treaties can become law only upon ratification by two-thirds vote of the Senate. U.S. Const. art. II, § 2 (App. A hereto.) By rejecting the Executive Branch's aspirations which were given voice in proposed article 9(4) of the US/UK Treaty, Congress' implied acquiescence in the state use of WWCR has become a part of the "supreme law of the land" (U.S. Const. art. VI(2); it cannot then be voided merely by relabeling the Executive Branch's thwarted aspirations as "foreign policy."

CONCLUSION

For the reasons given above, it is respectfully submitted that the petition for writ of certiorari should be denied.

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Respectfully submitted,

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APPENDIX A

CONSTITUTIONAL AND STATUTORY PROVISIONS

UNITED STATES CONSTITUTION

Article II, section 2, clause 2 (in part):

> [The President] shall have power, by and with the advice and consent of the Senate, to make treaties, provided two-thirds of the Senators present concur. . . .

UNITED STATES CODE

28 U.S.C. section 1257(a), in part:

> (a) Final judgments or decrees rendered by the highest court of a State in which a decision could be had, may be reviewed by the Supreme court by writ of certiorari . . . where the validity of a statute of any State is drawn in question on the ground of its being repugnant to the Constitution, treaties, or laws of the United States, or where any title, right, privilege, or immunity is specially set up or claimed under the Constitution or the treaties or statutes of, or any commission held or authority exercised under, the United States.

CALIFORNIA REVENUE AND TAXATION CODE

Section 25110 (water's edge election):

> (a) Notwithstanding Section 25101, a qualified taxpayer, as defined in paragraph (2) of subdivision (b) which is subject to the tax imposed under this part, may elect to determine its income derived from or attributable to sources within this state pursuant to a water's-edge election in accordance with the provisions of

this part, as modified by this article. A taxpayer which makes a water's-edge election shall take into account the income and apportionment factors of the following affiliated entities only:

(1) Affiliated banks or corporations which are eligible to be included in a federal consolidated return as described in Sections 1501 to 1505, inclusive, of the Internal Revenue Code, other than corporations making an election under Section 936 of the Internal Revenue Code.

(2) Domestic international sales corporations, as described in Sections 991 to 994, inclusive, of the Internal Revenue Code and foreign sales corporations as described in Sections 921 to 927, inclusive, of the Internal Revenue Code.

(3) Any corporation, regardless of the place where it is incorporated if the average of its property, payroll, and sales factors within the United States is 20 percent or more.

(4) Banks and corporations which are incorporated in the United States, excluding corporations making an election pursuant to Sections 931 to 936, inclusive, of the Internal Revenue Code, of which more than 50 percent of their stock is controlled directly or indirectly by the same interests, which are not included in paragraph (1).

(5) A bank or corporation which is not described in paragraphs (1) to (4), inclusive, or paragraph (6), but only to the extent of its income derived from or attributable to sources within the United States and its factors assignable to a location within the United States in accordance with paragraph (3) of subdivision (b). Income of such a bank or corporation

derived from or attributable to sources within the United States as determined by federal income tax laws shall be limited to and determined from the books of account maintained by the bank or corporation with respect to its activities conducted within the United States.

(6) Export trade corporations, as described in Sections 970 to 972, inclusive, of the Internal Revenue Code.

(7) Any affiliated bank or corporation which is a "controlled foreign corporation", as defined in Section 957 of the Internal Revenue Code, if all or part of the income of that affiliate is defined in Section 952 of Subpart F of the Internal Revenue Code ("Subpart F income"). The income and apportionment factors of any affiliate to be included under this paragraph shall be determined by multiplying the income of and apportionment factors of that affiliate without application of this paragraph by a fraction (not to exceed one), the numerator of which is the "Subpart F income", of that bank or corporation for that income year and the denominator of which is the "earnings and profits" of that bank or corporation for that income year, as defined in Section 964 of the Internal Revenue Code.

(8) (A) The income and factors of the above-enumerated banks and corporations shall be taken into account only if the income and factors would have been taken into account under Section 25101 if this section had not been enacted.

(B) The income and factors of a bank or corporation which is not described in paragraphs (1) to (4) inclusive, and (6) and which is

an electing taxpayer under this subdivision shall be taken into account in determining its income only to the extent set forth in paragraph (5).

(b) For purposes of this article and Section 24411:

(1) An "Affiliated bank or corporation" means a bank or corporation which is related to a bank or corporation, required to file under this part, because of any of the following:

(A) It owns directly or indirectly more than 50 percent of the voting stock of the bank or a corporation required to file under this part.

(B) More than 50 percent of its voting stock is owned directly or indirectly by a bank or corporation required to file under this part.

(C) More than 50 percent of voting stock of both it and the bank or corporation required to file under this part is owned or controlled directly or indirectly by any bank or person (as defined in Section 7701(a)(1) of the Internal Revenue Code).

(2) A "qualified taxpayer" means a bank or corporation which does both of the following:

(A) Files with the state tax return on which the water's-edge election is made a consent to the taking of depositions at the time and place most reasonably convenient to all parties from key domestic corporation individuals and to the acceptance of subpoenas duces tecum requiring reasonable production of documents to the Franchise Tax Board as provided in Section 26423 or by the State Board of Equalization as provided in Title 18, California Code of Regulations, Section 5005, or by the courts of this

state as provided in Chapter 2 (commencing with Section 1985) of Title 3 of Part 4 of, and Section 2025 of, the Code of Civil Procedure. The consent relates to issues of jurisdiction and service and does not waive any defenses a taxpayer may otherwise have. The consent shall remain in effect so long as the water's-edge election is in effect and shall be limited to providing that information necessary to review or to adjust income or deductions in a manner authorized under Sections 482, 861, Subpart F of Part III of Subchapter N, or similar provisions of the Internal Revenue Code, together with the regulations adopted pursuant to those provisions, and for the conduct of an investigation with respect to any unitary business in which the taxpayer may be involved.

(B) Agrees that for purposes of this article, dividends received by any bank or corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) from either of the following are functionally related dividends and shall be presumed to be business income:

(i) A bank or corporation of which more than 50 percent of the voting stock is owned, directly or indirectly, by members of the unitary group and which is engaged in the same general line of business.

(ii) Any bank or corporation which is either a significant source of supply for the unitary business or a significant purchaser of the output of the unitary business, or which sells a significant part of its output or obtains a significant part of its raw materials or input from the unitary business. "Significant," as used in this

subparagraph, means an amount of 15 percent or more of either input or output.

All other dividends shall be classified as business or nonbusiness income without regard to this subparagraph.

(3) The definitions and locations of property, payroll, and sales shall be determined under the laws and regulations which set forth the apportionment formulas used by the individual states to assign net income subject to taxes on or measured by net income in that state. If a state does not impose a tax on or measured by net income or does not have laws or regulations with respect to the assignment of property, payroll, and sales, the laws and regulations provided in Article 2 (commencing with Section 25120) shall apply.

Sales shall be considered to be made to a state only if the bank or corporation making the sale may otherwise be subject to a tax on or measured by net income under the Constitution or laws of the United States, and shall not include sales made to a bank or corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) in determining the amount of income of the taxpayer derived from or attributable to sources within this state.

(4) "The United States" means the 50 states of the United States and the District of Columbia.

(c) All references in this part to income determined pursuant to Section 25101 shall also mean income determined pursuant to this section.